DATE: September 2, 1997

MEMORANDUM TO: John F. Bovenzi, Director,
Division of Resolutions and Receiverships

FROM: Stephen M. Beard
Director, Congressional Relations
and Evaluations

SUBJECT: *Disposition of Assets with Environmental Hazards*
(Evaluation Report no. 97-009)

The Office of Congressional Relations and Evaluations has terminated its review of the Division of Resolutions and Receiverships' (DRR) program for disposing of assets with environmental hazards (environmental assets). The evaluation was terminated because our limited review found that the program was generally effective as shown by the fact that during the 11 months ending in June 1997, DRR had reduced the book value and number of environmental assets by 42 and 43 percent, respectively. This relates favorably to an overall 47 percent decrease in FDIC's entire asset portfolio over the same period. Also, there were only a small number of assets which were not marketable because they had serious environmental hazards. The steady decline in the environmental asset inventory and the positive results from our interviews were also factors which influenced our decision to curtail the review.

This report does not include recommendations. Accordingly, we did not issue a draft of this report for official comment. We did, however, provide a draft of the report to cognizant DRR and Legal Division officials to verify the accuracy of the facts presented. These officials generally agreed with our findings and their comments have been incorporated, where appropriate, throughout the report.

OBJECTIVES, SCOPE AND METHODOLOGY

The objective of the review was to determine whether DRR's program for disposing of assets with environmental hazards was effective. In addition, the review was designed to complement work being performed concurrently by DRR management under the Corporate Operating Plan Project (COPS) DI-CRP-05-02-97-935.

We limited the scope of this review to the disposition of owned real estate with environmental hazards. We did not review the management of specific assets except to obtain anecdotal evidence of disposition strategies. The review was based substantially on interviews with

DRR and Legal Division managers in the Southwest Service Center (SWSC) and Washington, D.C., and DRR personnel in the Western Service Center (WSC) and the Northeast Service Center (NESC). We interviewed Regional Managers; Assistant Regional Managers; Senior Liquidation Specialists, Liquidation and ORE Specialists (Account Officers); and a Regional and Senior Counsel. In addition, we interviewed environmental asset purchasers and brokers in Texas,
Missouri, and California. We reviewed management guidelines, policies, operating plans, the *Asset Disposition Manual*, and inventories of environmental assets.

We conducted our review between April 25, 1997, and June 24, 1997, in accordance with the President's Council on Integrity and Efficiency's *Quality Standards for Inspections.*

BACKGROUND

The Federal Deposit Insurance Corporation (FDIC) is responsible for the management and disposition of assets in its inventory. Environmental assets can be some of the most difficult assets to manage and dispose of. An asset is assigned an environmental code if environmental hazards have been identified on the property. Assets can be assigned more than one environmental code if more than one environmental hazard is present. Environmental hazards include hazardous substances, petroleum products, and pollutants or contaminants that may pose an immediate, delayed or long-term health and/or safety risk(s) to the public. Environmental hazards include, but are not limited to: asbestos containing materials, above and below ground storage tanks, lead based paint, pesticides, and soil contamination.

The management and disposition of environmental assets requires coordination between DRR account officers, the Legal Division, and the Headquarters Environmental Coordinator. This group works together to implement the Corporation's asset management and disposition strategy for the environmental assets in FDIC's inventory.

On June 6, 1996, the Division of Depositor and Asset Services, now DRR, issued a Management Action Plan for the Management and Disposition of Environmental Assets. The Plan's goal was to use an integrated management approach to maximize return and minimize risk(s) and losses associated with the management and disposition of environmental assets. Two of the Plan's objectives dealt directly with disposition issues. One objective was to address issues which were possible impediments to disposition efforts, such as (1) financing and pricing of environmental assets and (2) DRR property management agreements. The second objective was to implement aggressive marketing strategies for environmental assets.

Management also initiated a COPS project on April 4, 1997, titled "Management and Disposition of High Risk Assets." The Project's goal was to develop an expanded and ongoing headquarters oversight program for the management and disposition of high risk assets. High risk assets were more broadly defined as assets with "environmental hazards, structural weaknesses, vandalism, abandoned or unsecured real estate with an attractive nuisance, unpermitted occupancy, or unpermitted use of the property, especially any use of a criminal nature."

OBSERVATIONS

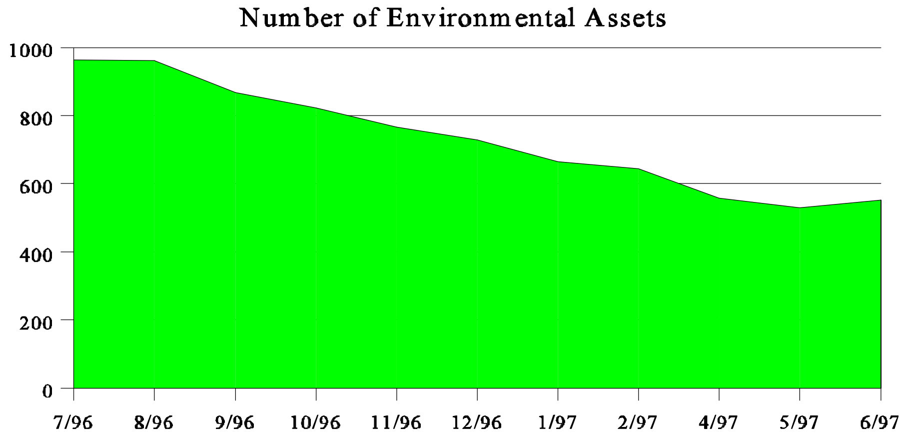
Inventory

DRR's program for disposing of environmental assets has generally been effective. Environmental assets present the Account Officers with additional marketing challenges because they must disclose the extent of environmental hazards and price the asset accordingly. However, during the 11 months ending in June 1997, DRR made steady progress in eliminating these assets from the inventory. DRR reduced the book value and number of environmental assets by 42 and 43 percent, respectively. This reduction relates favorably to an overall 47 percent decrease in FDIC's entire asset portfolio over the same period.

At June 1, 1997, there were 552 FDIC assets assigned environmental codes. DRR and Legal Division personnel told us there were about 50 or 60 assets with serious environmental hazards, or only 10 percent of the total number of environmental assets. The remainder of the environmental assets, according to those we interviewed, were properties with lead based paint, non-friable asbestos, and storage tank problems. However, DRR personnel considered those properties marketable.

As can be seen in the following graphs, DRR is making steady progress in reducing the inventory of environmental assets. Over the last 11 months, the number of environmental assets has decreased from 963 assets with a book value of $485.3 million to 552 assets with a book value of $279.6 million--a 42 percent reduction in book value in 11 months.

Figure 1: Decline in the Number of Environmental Assets



Notes: (1) February 1997 was the last report incorporating data from REOMS, and a Monthly Report was not prepared for March 1997.

(2) The slight increase in assets from May 1997 to June 1997 was the result of perfecting data in the Owned Real Estate System (ORES) and the final manual entry of environmental codes into ORES from the Real Estate Owned Management System (REOMS).

Source: DRR Monthly Reports "Current Resource and Hazard Data for Real Estate"

Figure 2: Decline in the Book Value of Environmental Assets

Book Valu

FDIC, whereas, they were used more extensively by RTC. The Management Action Plan resulted in service center managements' acceptance and use of special sales events for environmental assets. The Western Service Center is currently having a special environmental asset sales event and the Southwest Service Center has one scheduled for the fourth quarter of 1997.

Our review confirmed DRR's conclusion that there were no apparent impediments to the sale of environmental assets. DRR and Legal Division personnel told us they used the same disposition techniques for environmental assets as they used for assets that do not have environmental hazards. An Account Officer stated there are purchasers that actively pursue environmental assets because of the potential bargains that exist. Account Officers added that disclosing fully the nature and extent of the environmental hazards and establishing a fair sales price which takes into consideration the extent of those hazards is necessary to sell environmental assets. An Account Officer and real estate brokers told us they used similar methods to market those properties, including advertising in local newspapers and on the Internet. They also indicated that most purchasers were local entrepreneurs or neighboring property owners. Institutional investors who had been active purchasers of FDIC assets several years ago were no longer interested in purchasing FDIC assets because of the poor quality of the remaining assets.

We interviewed two buyers of environmental assets that were held by FDIC. They said their sales processes went very smoothly and one added that FDIC's Account Officers were very knowledgeable and responsive to his concerns. The two real estate brokers we interviewed also provided positive responses. One described his experience as outstanding and quick, and the other described the FDIC as very efficient in closing the real estate sales in which he was involved.

Use of Remediation Agreements

During our interviews, we detected some disagreement among the FDIC personnel involved in managing and selling environmental assets regarding FDIC's philosophy toward using remediation agreements. A remediation agreement is an agreement between the FDIC and the buyer, in which the buyer agrees to remediate an environmental hazard in accordance with applicable laws and regulations. The use of buyer remediation agreements to market and sell, or otherwise transfer, contaminated properties was mandated in certain limited situations by a July 29, 1996, DRR policy memorandum. These situations basically included those in which the Legal Division determined that FDIC would remain liable for some or all of the cost of remediation after the title to the property is transferred to the buyer or other entity, or where the Legal Division determines that the implementation of a buyer remediation agreement will settle, resolve or avert pending or threatened litigation or regulatory action. Also included were those situations where it would be cost effective for the FDIC to have a remediation agreement or where the expected cost of remediation is greater than the likely value of the property after completion of the remediation and other disposition alternatives are not feasible.

Sales personnel told us that, as a general rule, they preferred to dispose of assets without remediation agreements because the agreements complicated the sales process and required post-sale monitoring. They were also concerned with delays that have occurred in the sales process when the Legal Division was required to determine whether a remediation agreement was necessary to sell an asset. However, an Account Officer acknowledged that some of the remaining assets were of such poor quality, or in such a poor location, that the Corporation would need to use FDIC-funded remediation agreements before a buyer would be willing to accept title to the property. Sales personnel said DRR senior management was encouraging the use of remediation agreements in more cases than they thought was necessary. The Headquarters Legal Division environmental coordinator noted the use of remediation agreements should be very rare. The differences, according to individuals we interviewed, originated in the sales philosophies that existed at the Resolution Trust Corporation (RTC) and FDIC. Remediation agreements were common at RTC, but rarely used at FDIC.

From our limited inquiries, it seems that there may be some disagreement over when to use remediation agreements and Corporate policy on their use may need to be revisited. DRR and Legal Division management should consider jointly reviewing the July 29, 1996, policy memorandum addressing remediation agreements, and how it has been interpreted since its issuance, to ensure a consensus between the two divisions on when the agreements should be used.

Contracting for Necessary Services

We were told that it can take up to 6 months to contract for the most routine kinds of services, such as brokers and appraisers, that DRR needs to sell assets. These delays have discouraged potential purchasers who were interested in FDIC properties and caused them to back out of agreements to purchase environmental assets. We were also told that sales personnel had very little input into selecting the firms they would have to use and that some firms hired by FDIC were not qualified to perform the services. Also, some real estate broker contracts had been awarded to firms whose geographical territory did not include the subject property. DRR's difficulties in dealing with Acquisition Services Branch (ASB) and the emphasis on procuring the lowest cost bidder were a recurring subject during the course of our interviews. The DRR Environmental Program Coordinator told us that they were monitoring the field's ability to procure environmental assessments through ASB. He also stated that DRR and ASB are convening a task force of Headquarters and field office staff in late September 1997 to address alternatives for streamlining the process for procuring appraisals.

Corporate Operating Plan Project (COPS)

Headquarters DRR personnel told us the COPS project for high risk assets, which was initiated during April 1997, was established so that Headquarters could more closely monitor the management and sale of high risk assets and the project was primarily for the benefit of Headquarters staff, not the field. During our field visit, and in discussions with service center representatives, we were told that the COPS project required file reviews, preparation of risk assessments for each environmental asset, and preparation of quarterly status reports detailing the management and disposition strategies for environmental assets. Field staff we interviewed believed these tasks were very labor intensive and unnecessary considering the small number of high risk assets and required the reassignment of staff from liquidation activities. It was unclear to one employee how the additional risk reporting would contribute to asset sales and the employee questioned the value of future quarterly disposition strategy meetings considering the small number of assets with serious environmental hazards.

The DRR Environmental Program Coordinator told us that it was too early to tell the results of the COPS project because it is not scheduled for completion until March 31, 1998. He agreed that the COPS project was a new reporting workload for the service centers, but that the project was intended to improve Headquarters' oversight of high risk assets and increase the profile of these assets at the service centers through formal tracking of their status.

Both Headquarters and service center management agree that the COPS project requires a commitment of resources to the reporting process. In the draft of this report we suggested that Headquarters and service center management should consider working together to develop alternative methods for providing management information to Headquarters that would be less labor intensive than the current requirements. The DRR Environmental Program Coordinator responded that Headquarters has already taken steps to reduce the service center reporting requirements. He stated that monthly asset-specific reports are no longer required. Also, to date, reporting has consisted primarily of completing a one-page status report on each high risk asset and establishing goals for the third and fourth quarters. A third and fourth quarter status report will still be required. However, he also stated that they were developing a Headquarters level tracking system. This system will utilize a national asset data base and will allow Headquarters to retrieve information on environmental assets when the need arises, rather than requesting it from the service centers.

We were unable to evaluate the outcome of the COPS Project because it has not been fully implemented. However, the COPS Project has required the service centers to focus attention on high risk assets and, as stated previously, the steady decline in the environmental asset inventory is indicative that the overall program for disposing of environmental assets is progressing satisfactorily .